

Message Text

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SUBJECT: OCTOBER 20 ECONOMIC AND DEVELOPMENT REVIEW

COMMITTEE (EDRC) MEETING: ICELAND REVIEW

REFS: (A) OECD PARIS 26465

(B) OECD PARIS 26695

1. SUMMARY. DISCUSSION REFLECTED GENERAL AGREEMENT BETWEEN ICELAND AND SECRETARIAT ON CURRENT SITUATION, POLICY RECOMMENDATIONS AND SHORT-TERM PROSPECTS. ICELAND SLIGHTLY MORE OPTIMISTIC THAN SECRETARIAT CONCERNING ABILITY TO HOLD THE LINE DOMESTICALLY ON WAGES AND PRICES AND WITH RESPECT TO CURRENT ACCOUNT OUTLOOK. IN ADDITION, ICELAND NOTED SIGNIFICANT INFLUENCE OF OECD COUNTRY TRADE BARRIERS IN RESTRAINING GROWTH OF FISH EXPORTS. CURRENT ACCOUNT DEFICIT EXPECTED TO REMAIN LARGE IN 1975 AND 1976, AND WHILE NO CURRENT FINANCING PROBLEMS ARE EXPECTED, ICELAND FELT IT IMPRUDENT TO CONTINUE ACCUMULATING DEBT AT PRESENT RATES.

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2. BALANCE OF PAYMENTS OUTLOOK: ICELAND EXPRESSED GENERAL AGREEMENT WITH SECRETARIAT ANALYSIS OF CURRENT SITUATION AND SHORT-TERM PROSPECTS CONTAINED IN REF A, BUT EXPRESSED SOME SPECIFIC RESERVATIONS. EMPHASIZING VULNERABILITY OF ICELANDIC ECONOMY TO EXTERNAL INFLUENCES, ICELAND DEL POINTED TO ADVERSE EFFECT OF OECD COUNTRY PROTECTIONISM ON ICELANDIC FISH EXPORTS. ICELAND ASSERTED STRONGLY THAT WHILE OECD TRADE PLEDGE HAS HELD UP WELL, TRADE RESTRICTIONS IN THE FISH INDUSTRY PROVIDE A NOTABLE EXCEPTION. GOI PREDICTS 7-8 PERCENT INCREASE IN BOTH IMPORT AND EXPORT PRICES, BUT NOTED THAT GROWTH IN PROTECTIONISM COULD RESTRAIN EXPORT PRICE INCREASE AND THAT SECRETARIAT ESTIMATE OF LITTLE OR NO CHANGE IN EXPORT PRICES AND OVERALL DETERIORATION IN TERMS OF TRADE COULD BECOME A REALITY WITH CONSEQUENT EFFECTS ON CURRENT ACCOUNT BALANCE. IN ANY CASE, 1975-1976 CURRENT ACCOUNT DEFICIT WILL BE LARGE (4-6 PERCENT OF GNP) AND ALTHOUGH NOTING THAT NO ADVERSE LENDER REACTION HAD YET BEEN EXPERIENCED, ICELAND FELT THAT IT WOULD BE IMPRUDENT TO CONTINUE ACCUMULATING DEBT AT CURRENT RATES, ESPECIALLY IN VIEW OF SIGNIFICANT INCREASE IN DEBT SERVICE BURDEN IN 1975.

3. ON DOMESTIC SIDE, SECRETARIAT SOMEWHAT SKEPTICAL OF ICELAND'S ABILITY TO MAINTAIN RESTRICTIVE MONETARY AND FISCAL POLICIES THROUGH 1976. ICELAND NOTED THAT FISCAL AND MONETARY POLICIES SHOULD BE ROUGHLY CONSISTENT WITH TRIPLE OBJECTIVE OF MAINTAINING EMPLOYMENT, REDUCING INFLATION AND INCREASING REAL GNP GROWTH, BUT THAT GOI WOULD RELY PRIMARILY ON INCOMES POLICY AND WAGE RESTRAINT TO ACHIEVE THESE GOALS SIMULTANEOUSLY. ICELAND AGREED WITH SECRETARIAT ASSESSMENT PRICE OUTLOOK IS NONETHELESS UNSTABLE AND THAT DOMESTIC DEMAND WOULD RISE ONLY SLIGHTLY IN 1976.

4. POLICY CONSIDERATIONS: SECRETARIAT'S RECOMMENDATIONS WERE AIMED AT INCREASING EXPORT REVENUE STABILIZATION EFFECT OF FISHERIES PRICE STABILIZATION FUND (FPSF), EXTENDING CONTROL OVER CREDIT CREATION AND REDUCING ANTICYCLICAL BIAS OF TAX SYSTEM. IN RESPONSE, ICELAND NOTED LIMITED OFFICIAL USE

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THAT FPSF HAD STRONG STABILIZATION IMPACT, INJECTING AMOUNTS EQUAL TO 1-1/2 PERCENT OF GNP INTO ECONOMY DURING 1975 RECESSION. IN ADDITION, MEASURES WERE BEING TAKEN TO CHANNEL RESOURCES FROM NON-BANK FINANCIAL INSTITUTIONS INTO PRODUCTIVE INVESTMENT, AND LEGISLATION HAS BEEN INTRODUCED TO FORMALIZE GOVERNMENT CONTROL OVER COMMERCIAL BANK CREDIT EXPANSION. WHILE GOI NOT READY TO PUT TAX COLLECTIONS ON "PAY-AS-YOU-EARN BASIS," IT

PLANS TO INTRODUCE SOME FLEXIBILITY IN PROVIDING FOR
COLLECTION OF VARYING PROPORTIONS OF ANNUAL LIABILITY
DEPENDING ON CONJUNCTURAL SITUATION.
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